25TH ANNUAL

Corporate Finance Disclosure Report

ASC
Alberta Securities Commission

DECEMBER 2015

*This report is the Alberta Securities Commission's **(ASC)** 25th annual Corporate Finance Disclosure Report **(Report)**. This edition reflects the ASC's long-standing focus on ensuring public disclosure by reporting issuers **(RI)** is of the highest quality. Based on feedback received we believe the Report continues to be an effective way to communicate information on a regular basis.*

Over the past 25 years, an assortment of trends have emerged and continue to evolve. These include vastly increased market speed and complexity; significantly more prescriptive disclosure requirements; increased focus on internal controls, corporate governance matters and the environment; increased shareholder activism; and increased globalization.

These trends have necessarily increased the intensity, scrutiny and volume of financial reporting and other required RI disclosure, bringing both benefits and challenges. Accordingly, clear and concise narration and the prudent exercise of judgement by management and their advisors in preparing their public disclosure is paramount. We have often suggested over the years that the best disclosure is not the longest. Market participants will continue to trust and value the most clear and forthright disclosure.

This year's report comes at what is possibly the most difficult market circumstance for Alberta's energy industry participants since the ASC began providing commentary on disclosure. The erosion of key commodity prices brings to the forefront concerns around asset impairment as well as the impact on liquidity. A full year into this cycle has only deepened the impact of these factors on the Alberta capital market, and perhaps widened the circle of impact into other industries. New and anticipated developments in the areas of climate policy and the Alberta royalty regime may present disclosure considerations in the new year ahead.

In our view, on the whole, RIs and their advisors have been extremely responsible and responsive to the evolving landscape and the extraordinary market conditions. We thank them for their co-operation in responding to our concerns when raised.

In addition to those areas noted around impairment and liquidity, in our upcoming disclosure reviews we will be paying particular attention to emerging financing structures and how they are being reported. We will also continue to look carefully at financial information disclosed outside the financial statements including non-GAAP measures to assess their consistency and portrayal of results. We also remain focused on an enduring first principle of sound reporting -- the timing of disclosure. Bad news is difficult to disclose, however it rarely improves with time. We will continue to take action as quickly as possible when potentially misleading disclosure is identified.

When the markets turn, trustworthy and accurate continuous disclosure, absent of surprise, will be the platform on which RIs can take advantage of capital raising windows in a timely and efficient manner.

We are hopeful this Report continues to create dialogue not only among RIs, their advisors and market participants, but also with us. We welcome your feedback on its content and areas of disclosure that are of concern in RI financial reporting and disclosure. We take your comments into consideration when preparing future communications.

Tom Graham
Director, Corporate Finance

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In this Report, the following terms have the meanings set forth below unless otherwise indicated. Words importing the singular number only include the plural, and vice versa.

"AIF" means Annual Information Form, specifically, a completed Form 51-102F2 *Annual Information Form* **(Form 51-102F2)**;

"CD" means Continuous Disclosure;

"CSA" means the Canadian Securities Administrators;

"CPC" means Capital Pool Company;

"CTO" means Cease Trade Order;

"E&E" means Exploration and Evaluation Assets, as that term is defined in IFRS 6 *Exploration and Evaluation of Mineral Resources*;

"FLI" means Forward-looking Information; specifically, disclosure regarding possible events, conditions or financial performance that is based on assumptions about future economic conditions and courses of action and includes future-oriented financial information with respect to prospective financial performance, financial position or cash flows that is presented either as a forecast or a projection (as defined in National Instrument 51-102 *Continuous Disclosure Obligations* **(NI 51-102)**);

"Form 41-101F1" means Form 41-101F1 *Information Required in a Prospectus*;

"GAAP" means Generally Accepted Accounting Principles;

"IAS 1" means International Accounting Standard **(IAS)** 1 *Presentation of Financial Statements*;

"IAS 21" means IAS 21 *The Effects of Changes in Foreign Exchange Rates*;

"IAS 36" means IAS 36 *Impairment of Assets*;

"IAS 39" means IAS 39 *Financial Instruments: Recognition and Measurement*;

"IFRS" means International Financial Reporting Standards, specifically, the standards and interpretations adopted by the International Accounting Standards Board, as amended from time to time;

"IFRS 6" means IFRS 6 *Exploration for and Evaluation of Mineral Resources*;

"IFRS 7" means IFRS 7 *Financial Instruments: Disclosures*;

"MCR" means Material Change Report; specifically, a completed Form 51-102F3 *Material Change Report*;

"MD&A" means Management's Discussion and Analysis, specifically, a completed Form 51-102F1 *Management's Discussion & Analysis* **(Form 51-102F1)**;

"NI 51-101" means National Instrument 51-101 *Standards of Disclosure for Oil and Gas Activities*;

"NI 52-109" means National Instruments 52-109 *Certificates of Disclosure in Issuers' Annual and Interim Filings*;

"PP&E" means Property, Plant and Equipment as that term is defined in IAS 16 *Property, Plant and Equipment*; and,

"Venture RI" means Venture Issuer, as that term is defined in NI 51-102.

1. The Alberta Capital Market

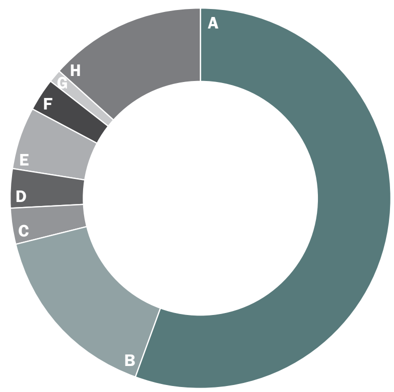
Market Capitalization and Industry Type

Alberta has the second largest capital market in Canada. The market capitalization of Alberta-based[1] RIs constitutes approximately 22 per cent of active Canadian RIs[2]. The ASC regulates 667 Alberta-based RIs representing a diverse range of industries. The oil and gas industry comprises the majority of RIs with 56 per cent of the total Alberta market capitalization.

Market Capitalization

ACTIVE CANADIAN RIs

22%	**Alberta** (A)
6%	**British Columbia** (B)
49%	**Ontario** (C)
17%	**Quebec** (D)
6%	**Other Provinces** (E)



ALBERTA-BASED RIs BY INDUSTRY

56%	**Oil & Gas** (A)
16%	**Pipelines** (B)
3%	**Oil & Gas Services** (C)
3%	**Utilities** (D)
5%	**Transportation & Environmental Services** (E)
3%	**Industrial** (F)
1%	**Mining** (G)
13%	**Other** (H)

Corporate Finance

The ASC is entrusted with protecting investors and with fostering a fair and efficient capital market. The mandate of the Corporate Finance division is to establish and sustain confidence in the Alberta capital market by ensuring that investors have access to timely, reliable and relevant information to make informed investment decisions. Our efforts towards this goal include: oversight and review of the Alberta capital market; policy research and rule development; and outreach to issuers, investors and professional advisors to promote a high level of compliance and to obtain their feedback.

To meet the ever-changing complexities of our RIs, the Corporate Finance division is comprised of a diverse group of professionals with a broad range of expertise. While applying our expertise to all industries represented in the Alberta capital market, our core focus is to sustain our regulatory leadership in the oil and gas industry.

This Report presents our observations from reviews of CD and offering documents completed during the year and identifies key areas where issuers can improve disclosure. To establish our expectations and provide practical guidance to issuers, where possible we provide examples, practice tips and reminders.

[1] Represents RIs whose principal regulator is Alberta.
[2] Represents RIs based in Canada that are listed on the TSX or TSXV. Source: TMX Group, October 31, 2015.

2. Review Process & Outcomes

CD Reviews

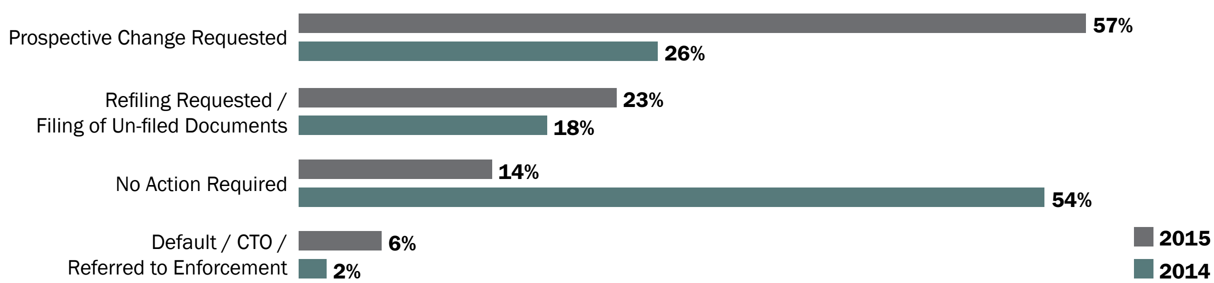
The ASC CD review program is a key priority of the Corporate Finance division. We conduct CD reviews to ensure that RIs are in compliance with regulatory requirements and to provide direct feedback to RIs on how to improve their disclosure. Our program involves two types of CD reviews: full CD reviews and issue-oriented reviews **(IORs)**.

The scope of our full CD reviews is broad and will usually include an assessment of an RI's financial reporting and other required disclosures for its most recently completed annual and interim periods, including: financial statements, MD&A, business acquisition reports, information circulars, news releases, MCRs, AIFs (if applicable) and other relevant disclosures. Additionally, we may also review and assess other disclosures such as websites, webcasts and investor materials.

IORs focus the scope of our review on particular disclosures, issues or requirements. We conduct some IORs jointly with other members of the CSA, while other IORs are ASC-specific.

This year's IORs included specific disclosure issues in news releases, investor presentations, information circulars, MD&As and financial statements. One IOR we conducted this year included the review of RIs' disclosure of the use of proceeds from financings by way of shelf prospectuses. We discuss some of our observations from this review in the Shelf Prospectus Supplements section of this Report.

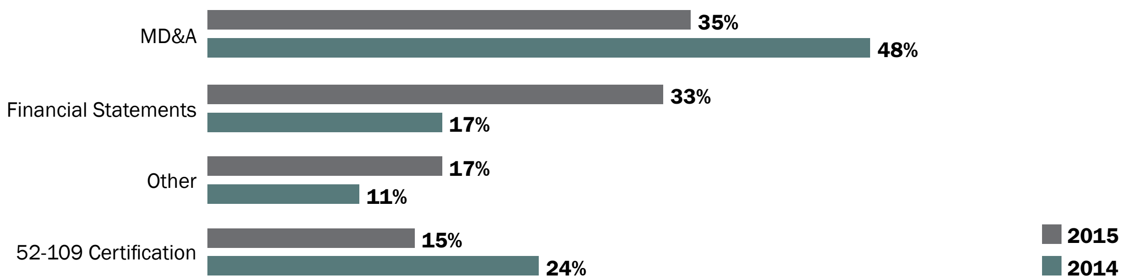
CD Review Outcomes



As illustrated above, 86 per cent of our CD reviews in 2015 resulted in an action outcome: we either requested that the issuer make prospective changes or re-file/file documents, or we placed the issuer on the default list, cease traded the issuer or referred the file to enforcement for further investigation. The "no action" and "prospective change" categories had the most significant changes from 2014. This was primarily due to our focus on full CD reviews in 2015 as compared to 2014 where we completed a significant number of IORs. One significant IOR carried out in 2014 was the review of all Alberta-based non-venture RIs' NI 52-109 disclosures, where 87 per cent of the RIs reviewed resulted in a no action outcome. While the 2015 outcomes in the "no action" and "prospective change" categories were more consistent with years prior to 2014, there was an overall increase in the number of prospective changes required.

Twenty three per cent of the actions taken in 2015 were to request that issuers re-file or file un-filed documents. Unfiled documents comprise 41 per cent of this category, with the most significant portion being unfiled material contracts, executive compensation and other corporate governance disclosures.

Nature of Re-filings



As demonstrated in the chart above, the largest increase in re-filings was related to the “financial statements” and “other” categories. While the re-filings related to MD&As decreased year over year, this category remains the largest percentage of the overall re-filings. The re-filings resulted primarily due to overall disclosure deficiencies in the MD&A and changes required as a result of re-filed financial statements.

Offering Document Reviews

During the 12 months ended November 30, 2015, there was a total of 99 offering documents filed by RIs and issuers where Alberta is the principal regulator, a twenty three cent decrease from the prior year. The overall decline reflects the continued uncertainty in the capital markets.

Type of Filing	12 months ended November 30, 2015	12 months ended November 30, 2014	% Change
Initial Public Offering (IPO) Prospectus	12	14	(14 %)
Long Form Prospectus	4	2	100 %
Short Form Prospectus	75	104	(28 %)
Rights Offering Circular	3	6	(50 %)
CPC Prospectus	6	2	200 %
Total	**99**	**128**	**(23 %)**

3. Notable Review Observations

3.1 Financial Statements and Related Disclosures

A. Impairment

IAS 36 prescribes the procedures that RIs must apply to ensure that their assets are carried at no more than the amounts expected to be recovered through their use or sale. To accomplish this objective, IAS 36 provides guidance on identifying assets that may be impaired, on impairment testing and the recognition or reversal of any impairment losses and the related disclosures.

PP&E and E&E Assets

Given continued weak commodity prices and market conditions, we have raised questions in certain circumstances about the recoverability of the carrying amount of assets. We noted that several RIs identified impairment triggers and performed impairment testing at the end of their reporting period(s). While our reviews considered whether those RIs who recorded impairment losses met the overall IAS 36 disclosure requirements, we also looked at the timing of potential or noted impairment triggers and the timing of the RIs' resulting impairment assessment, if any.

Triggers and Timing

IAS 36 requires an RI to assess, at each reporting date, whether there are any indicators that PP&E assets may be impaired. An RI is required to consider information from both external sources (e.g., market interest rates, significant adverse changes in the technological, market, economic or legal environment in which the entity operates, market capitalisation being lower than net assets) and internal sources (e.g., internal restructurings, evidence of obsolescence, physical damage to the asset). Paragraph 12 of IAS 36 provides examples in assessing whether there is any indication that an asset may be impaired. The examples provided are not exhaustive and an RI should consider its specific facts and circumstances when assessing, at each reporting date, whether there is any indication that an asset may be impaired.

For E&E assets, IFRS 6 also requires an RI to assess for impairment when facts and circumstances suggest that the carrying amount of the assets may exceed their recoverable amount. Paragraph 20 of IFRS 6 sets out some potential indicators that the assets may be impaired.

In our reviews, we looked at whether there were indicators that an impairment trigger existed at the end of a reporting period. In one example, the RI indicated that no impairment indicators existed for their E&E assets at the end of their reporting period; however, we noted that regulatory approval for the development of one of the RI's material properties was significantly delayed. Both the uncertainty associated with the licence's regulatory approval and the RI's history of writing-off expired licences suggested factors as per paragraph 20(a) of IFRS 6, which indicated that the RI might not have the intent or the ability to retain the property/licence or its rights to explore. We inquired as to whether the RI considered this to be an impairment indicator. The RI clarified that, at the end of the reporting period, the development licence approval was in the final stages and the final approval was actually obtained approximately three months after the reporting period ended. As such, the RI did not consider this factor to be an impairment indicator on its own.

In another example, we noted an RI's operating netback[3] had a material decrease from the three month period ended December 31, 2014 to the three month period ended March 31, 2015. It was ambiguous whether this, combined with other internal and external factors noted, was indicative of a longer term condition that economic performance will be worse than expected, as per paragraph 12(g) of IAS 36. The disclosure in the RI's March 31, 2015 interim financial report was unclear whether the RI considered this negative operating netback measure as an indicator of impairment and whether an impairment test was performed on the RI's PP&E assets as at March 31, 2015. Upon inquiry, the RI clarified that an impairment test had been performed as a result of noted impairment indicators, one being the negative operating netback measure.

For both of these noted examples we required improvement in future disclosures. For the first example, while unrelated to the RI's specific impairment disclosures, we required updates on the timing for regulatory approval on the RI's significant project[4]. For the second example, we required disclosure of the significant judgements, assumptions and estimates made by the RI, given the significance of the cash generating unit **(CGU)** and heightened risk of a material adjustment based on key assumptions subject to estimation uncertainty.

During the year we also looked at the timing of impairment tests and/or the recognition of impairment losses. In one example where we questioned the timing of an RI's impairment assessment, the RI recorded a $5.2 million impairment on two of its CGUs during the fourth quarter ended September 30, 2015. The impairment test trigger was lower forecasted commodity prices. The RI also disclosed this as the event or circumstance that led to the impairment loss. However, we noted significant declines in selling prices and production volumes starting in January 2015. Although the price decrease in itself may not be an impairment indicator, when combined with other factors, such as the RI's significant production declines, it caused us to question the timing of the RI's impairment assessment and whether and there should have been an impairment assessment performed in an earlier period.

Upon inquiry, the RI advised us that the last PP&E impairment test was conducted during its fourth quarter in 2012 when the RI last noted impairment triggers. The RI indicated an impairment assessment for the CGUs was not conducted prior to September 30, 2015 as its year-end reserve report was not available. While the RI's process was to use its year-end reserve report for measuring recoverable amounts in its impairment assessment, the timing and availability of the reserve report is not an acceptable reason for the RI to defer impairment calculations or assessments. In accordance with paragraph 9 of IAS 36, if there is any indication that an asset may be impaired at the end of a reporting period, an RI shall estimate the recoverable amount of the asset or CGU. We advised the RI that we expect it to comply with paragraphs 7 to 17 of IAS 36 when identifying an asset or CGU that may be impaired and to perform an impairment test on a timely basis.

> *PRACTICE TIP*
>
> Paragraph 23 of IAS 36 states that in some cases estimates, averages and computational short cuts may provide reasonable approximations of the detailed computations for determining fair value less costs of disposal or value in use.

Impairment Disclosure

During the year we also focused on reviewing RIs' impairment disclosures. For several RIs we noted that there was incomplete disclosure of the specific judgements and assumptions used in an RI's impairment testing.

[3] The operating netback disclosure was consistent with the disclosure under section 5.8.2 of the Companion Policy NI 51-101 (i.e., revenues less royalties less operating costs).

[4] Disclosure required under paragraph 1.4(d) of Form 51-102F1 for issuers that have significant projects that have not yet generated revenue.

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

An RI's annual financial statements disclosed the following in its PP&E financial statement note:

Management performed an impairment analysis of the carrying value of goodwill and has made the determination that the recoverable amount of the Drilling CGU assets exceeds their carrying amount, including goodwill. The recoverable amount of the Drilling CGU was determined based on a value in use calculation which utilizes a five year cash flow projection based on the Corporation's currently planned and approved budget for 2015 and for the ensuing four years. The projected cash flows are based on management's best estimate of equipment utilization rates, pricing and required maintenance capital. The key assumptions that would impact the estimated recoverable amount are the projected cash flows and discount rates. Management used a pre-tax discount factor of 15% in assessing the recoverable amount of this CGU.

In the financial statement note, the RI did not disclose or quantify the key assumptions used in calculating its projected cash flows. Upon inquiry, the RI provided the following key assumptions (among others) used in calculating its expected cash flows:

	Cash Flow as a percentage (%) to previous year
2015	–50%
2016	70%
2017	20%
2018	3%
2019	3%

We further inquired what key assumptions the RI used in determining its cash flow growth assumptions for the years 2016, 2017 and 2018. The RI provided support in the form of both qualitative and quantitative information, outlining that the significant assumptions used in determining cash flows were (i) utilization rates and (ii) forward pricing. We also noted that the RI did not provide information, as required under IAS 36.134(d)(iv), on the growth rate used to extrapolate cash flow projections beyond the period covered by the RI's most recent budget (i.e., 2015). The RI agreed to improve its impairment disclosures in its financial statements on a go-forward basis by including additional information on the significant assumptions similar to those provided in response to our inquiries.

If RIs have performed their impairment testing and determined that there is no impairment, IAS 36 does not require any specific impairment disclosures. However, for many RIs the impairment analysis process entails their most difficult, subjective and complex judgements. Paragraphs 122 and 125 of IAS 1 require disclosure in the financial statements of the significant judgements, assumptions and estimates used by the RI. Where an RI has performed an impairment test during a reporting period, and where IAS 1 disclosure of key judgements, assumptions and estimate uncertainty is triggered, the disclosure would likely include: the methodology used in the impairment calculation (value in use or fair value less costs of disposal); the timing of events and cash flows; discount rate(s); and other significant estimates and assumptions used in its impairment calculations (such as expected prices, utilization, growth rates). In cases where a reasonably possible change in a key assumption or estimate used in an RI's impairment test could cause the carrying amount of the asset(s) or CGU(s) to exceed their recoverable amount within the next financial year, an RI should consider disclosing a sensitivity analysis. In the analysis, the change to a key assumption or estimate and its impact on the asset(s) or CGU(s) recoverable amount and its resulting impact, if any, to the recorded impairment, would be disclosed.

EXAMPLE THAT MET OUR EXPECTATIONS

An RI's annual financial statements disclosed the following in its PP&E financial statement note:

(000's)

At December 31, 2014, the Company tested its CGUs for impairment as well as the potential reversal of prior period impairments where indicators were present. It was determined that the carrying amounts of the Property A, Property B, Property C, Property D, Property E, and Property F CGUs all exceeded their recoverable amount. Recoverable amount was calculated as the fair value of the assets less cost of disposal. The fair value less cost to dispose was determined with a discounted cash flow approach based on year end 2014 proved plus probable reserves and market commodity prices. The Company used a risk adjusted discount rate that varied by CGU based on the nature of the assets held in each CGU to determine the fair value at the measurement date (level 3 inputs). The impairment was attributed to property, plant and equipment and, as a result, an impairment loss of $121,926 was recorded (2013 – $2,805).

The following table summarizes the impairments, recoverable amount and discount rate used for each CGU that was impaired.

CGU	Recoverable amount (000's)	Risk adjusted discount rate (%)	Impairment recorded (000's)
Property A	21,680	10.0	14,708
Property B	62,310	10.0	5,616
Property C	40,293	10.0	25,386
Property D	34,353	12.0	6,845
Property E	48,054	13.5	38,030
Property F	72,408	13.5	31,341
Total	279,098		121,926

The impairment was primarily attributable to the decline in future oil and natural gas prices used in the independent reserve evaluation. A one percent increase in the assumed discount rate would result in an additional impairment of $22,070 for 2014 (2013 – $1,584) while a ten percent decrease in future planned cash flows would have increased the impairment loss for 2014 by $37,488 (2013 – $3,089).

The table below summarizes the benchmark prices for the next ten years used by the independent reserve evaluators in preparing the Company's reserve report. The annual escalation rate used after 2024 is 2.0%.

	WTI Cushing Oklahoma ($US/bbl)	Edmonton Par 40 API ($CDN/bbl)	Alberta AECO-C ($CDN/mmbtu)	Foreign Exchange ($US/$CDN)
2015	62.50	64.71	3.31	0.850
2016	75.00	80.00	3.77	0.875
2017	80.00	85.71	4.02	0.875
2018	85.00	91.43	4.27	0.875
2019	90.00	97.14	4.53	0.875
2020 – 2024	95.00 – 104.57	102.86 – 112.67	4.78 – 5.71	0.875

Goodwill or Intangible Assets with Indefinite Useful Lives

For several RIs we also noted missing disclosures in respect of the impairment tests performed for goodwill and intangible assets with indefinite useful lives. We noted that these RIs had not included details about their impairment testing in their annual financial statements. When we inquired as to why impairment disclosures had not been included in the RI's annual financial statements, the RI indicated that impairment disclosures were not provided because no impairment loss was recorded during the period. As the carrying amount of goodwill allocated to the CGU was significant in comparison to the total carrying amount of goodwill for these RIs, the impairment disclosures outlined in paragraph 134 of IAS 36 were required, regardless of whether an impairment loss was recognized.

REMINDER

Paragraph 134 of IAS 36 requires the following disclosures for each CGU where the carrying amount of goodwill allocated to the CGU is significant in comparison to the RI's total carrying amount of goodwill:

- the carrying amount of goodwill allocated to the CGU;
- the basis on which the CGU's recoverable amount has been determined (i.e., value in use or fair value less costs of disposal);
- if the CGU's recoverable amount is based on value in use, provide the disclosures required by IAS 36.134(d);
- if the CGU's recoverable amount is based on fair value less costs of disposal, provide the disclosures required by IAS 36.134(e); and
- if a reasonably possible change in a key assumption on which management has based its determination of the CGU's recoverable amount would cause the CGU's carrying amount to exceed its recoverable amount, provide the disclosures required by IAS 36.134(f).

These disclosures are required when the annual impairment test is performed, regardless of whether an impairment loss is recognized.

B. Credit Risk

The objective of IFRS 7 is to ensure disclosure is provided about the significance of financial instruments to an entity and the nature and extent of risks arising from those financial instruments and how the entity manages those risks.

This past year we noted several RIs had experienced an increase in their aged accounts receivables. Our reviews considered the overall IFRS 7 disclosure, with a focus on the quantitative disclosure requirements under paragraph 37 and concentration of risk under paragraph 34.

For several RIs, we noted that there was missing disclosure of an aged analysis of financial assets that were past due but not impaired. Also missing was an analysis of financial assets that were individually determined to be impaired as at the end of the reporting period, including the factors the entity considered in determining that they were impaired, as outlined in paragraphs 37(a) and (b) of IFRS 7.

In some instances we also noted RIs had failed to disclose significant receivables past due that were concentrated in one or few customers, as required by paragraph 34.

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

An RI's Annual Financial Statements credit risk note disclosed the following:

(000's)	December 31, 2014	December 31, 2013
Revenue and other receivables	34,050	37,500
Joint operation receivables	13,500	22,000
Allowance for doubtful accounts	(2,550)	(2,500)
Accounts Receivable	45,000	57,000

At December 31, 2014, the Company had $6.2 million (2013 – $12.9 million) of receivables that were considered past due.

The RI did not disclose an analysis of the age of the accounts receivable that were past due; but not impaired. In addition, while the disclosure provided the amount past due, the basis for that determination was not clear. We inquired as to the aging of its receivables, the basis for the RI determining its allowance for doubtful accounts and how the prevailing economic conditions impacted that determination. The RI indicated that collections usually occur in the 91-180 day range and it considers net receivables of 3 years or older to be uncollectable or past due. The RI provided staff with an aging analysis on the December 31, 2014 accounts receivable:

Accounts Receivable Aging at December 31, 2014	<30 days	31-60 days	61-90 days	91-180 days	>180 days	Total
Revenue and other receivables	32,400	–	–	–	–	32,400
Joint operation receivables	4,700	1,350	400	1,600	7,100	15,150
Allowance for doubtful accounts					(2,550)	(2,550)
Accounts Receivable	37,100	1,350	400	1,600	4,550	45,000

The RI advised staff that given the economic environment in addition to its "tightened-up" collection process, it had increased its allowance for doubtful accounts by $1 million for the six month period ended June 30, 2015. We noted however that the subsequent filing of the June 30, 2015 interim financial report did not provide any indication that an additional $1 million was added to the allowance for doubtful accounts, as required by paragraph 16 of IFRS 7. In addition, the RI did not disclose the reason for this policy and process change as required by paragraph 33 of IFRS 7. We advised the RI that we would require these disclosures in their next filing.

C. Disclosing Nature of Expenses

RIs that present their expenses classified by function are required, by paragraph 104 of IAS 1, to provide note disclosure for additional information on the nature of the expenses, including depreciation and amortization expense and employee benefits expense, because information on the nature of expenses is useful in predicting future cash flows.

Through our CD reviews we have identified that some RIs are not providing the additional note disclosure at all. Other RIs disclose a breakdown by nature, but include a significant amount labelled as "other", which makes it impossible for readers to determine the nature of the other expenses. These RIs have been advised to improve their disclosure by presenting the required disclosures at an appropriate level of detail so that the intended benefit can be realized.

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

An RI's Annual Financial Statements presented the following expenses in its Statement of Loss and Comprehensive Loss for the year ended December 31, 2014:

(000's)	
Expenses	
Operating	$ 150,000
General and administrative	50,000
Finance income and expenses	500
Share-based compensation	10,000
Depletion and depreciation	110,000
Impairment	165,000
	$ 485,500

The RI's statement of profit or loss and other comprehensive income did not present any note disclosure describing the nature of the expenses that comprised the operating expense line items. As a result, we inquired as to the composition of these amounts.

The $150 million in operating expenses included several material components that should have been disclosed separately, such as:

- **$30 million in salaries, benefits and labour costs;**
- **$26 million in transportation costs; and**
- **$34 million in maintenance costs and other.**

The RI confirmed that it reassessed its disclosure and would be disaggregating the information into three major categories in its future reporting.

D. Functional Currency

Significant judgement disclosure has been an area of our focus since the transition to IFRS. Generally, one area of significant judgment for RIs that have foreign operations relates to the determination of functional currency for the entities that comprise the RI; however, we have noted that for several RIs that have material foreign operations, the judgment disclosure related to functional currency is lacking.

In accordance with IAS 21, each entity determines its functional currency in accordance with paragraphs 9 through 14 of IAS 21. Functional currency is a factual determination as opposed to an accounting policy choice. The application of this guidance requires RIs to assess several factors and judge which currency most appropriately represents the primary economic environment in which the entity operates. We have questioned some RIs on both their application of this IFRS and the related disclosure.

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

An RI with a material foreign operating subsidiary changed the functional currency of the foreign entity effective January 1, 2014. The RI's consolidated financial statements for the years ended December 31, 2013 and 2014 included the following note disclosures:

- Basis of Presentation Note: "The consolidated financial statements are presented in Canadian dollars, which is the Company's functional currency. Currency X was the functional currency of ForeignSub up to December 31, 2013, at which time it was changed to the United States Dollar (USD). The USD is the functional currency of all subsidiaries."
- Critical Judgements Note: "The determination of the ForeignSub's functional currency requires assessing several factors, including the dominant currency used in transactions such as the settlement of revenues and operational and capital expenditures. Management used its judgment to assess these factors and concluded its functional currency was the USD."
- Accounting Changes Note: "The change in functional currency coincides with a significant acquisition in Country X, along with the evolving business activities in this subsidiary and the economic environment in Country X that has become more influenced by the USD over time."

The RI's disclosure was considered to be boilerplate. As a result, we raised comments requesting the RI to support the basis of change in functional currency, including the factors assessed in determining the new functional currency.

Although the note disclosure and the RI's response indicated that the change in functional currency corresponded to the significant acquisition in Country X completed by the RI in December of 2013, the RI had material operations, including significant revenues, from its pre-existing Country X properties. As such, there was uncertainty as to whether there was actually a change in the underlying transactions, events and conditions that are relevant to the ForeignSub, and as to the timing of any such change[5].

The RI's analysis supporting USD as the new functional currency stated that the indicators in paragraph 9 of IAS 21 were mixed. However, the main factors included:

- **the benchmark price for oil and natural gas was set in USD;**
- **the revenues were invoiced in USD;**
- **most of the operating costs were transacted and invoiced in Country X currency;**
- **most of the capital costs were regularly transacted and invoiced in USD; and**
- **settlement of all invoices was in Country X currency.**

This analysis focused on the currency in which the sales and costs were denominated, but not necessarily the primary economic environment in which the entity operated and the currency that mainly <u>influenced</u> the sales prices or the labour, material and other costs.

The fact that revenues are invoiced in USD does not necessarily indicate that this currency influences these sales prices. Specifically, prior to 2015, the Country X government would override the global market by regulating domestic pricing; as such, the influence on sales prices would be more weighted on the Country X area rather than the US. We did note that starting in 2015, the domestic pricing for Country X is more directly tied to the US.

Finally, despite stating that the primary indicators were mixed, the RI made no mention of the secondary indicators (i.e., the factors in paragraphs 10 and 11 of IAS 21 that provide additional supporting evidence to determine functional currency).

As a result, we requested increased disclosure of the key judgements relating to the determination of ForeignSub's functional currency in the RI's future disclosure, taking into account the factors that support the primary as well as the secondary factors considered.

IAS 21 gives greater emphasis to the economy that determines the pricing of transactions, as opposed to the currency in which transactions are denominated and settled. As a result, the factors in paragraph 9 are specifically identified as the primary factors and should be more heavily weighted. RIs should also consider the additional supporting evidence related to the secondary and additional factors in paragraphs 10 and 11. When this is the case, these additional considerations would also be relevant in the judgment disclosure.

[5] Paragraph 13 of IAS 21 – "An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events or conditions."

3.2 MD&A Disclosure

A. Liquidity and Capital Resources

We have discussed the importance of comprehensive, RI-specific liquidity and capital resource disclosure in many past Reports; however, this year, in light of the challenging economic environment that many of our RIs are facing, strong disclosure is paramount. While we have noted weak disclosure regarding liquidity risk in the past, investors will be less tolerant of boilerplate discussions since some of these risks may have materialized this year. Of significant importance to investors will be disclosure of steps taken to address this risk and the RI's specific risk management plans moving forward. As a result, to the extent that they are prepared appropriately, the liquidity and capital resources sections of RIs' MD&As (Sections 1.6 – *Liquidity* and 1.7 – *Capital Resources* of Form 51-102F1, respectively) should be a key source of this critical information.

For some of our RIs, the question, and resulting analysis, of an RI's ability to generate sufficient amounts of cash and cash equivalents to maintain capacity, planned growth and fund development activities has been, and will continue to be, a real challenge. While we have seen some improvement over the past few years with respect to liquidity and capital resource disclosure, we continue to see some RIs simply repeat in the MD&A what is already in their financial statements, which is generally insufficient to provide the more comprehensive insight expected in the MD&A.

In one example, the condition of the RI's liquidity and capital resources had deteriorated in the most recently completed annual period. The financial statements presented a going concern note, the RI had insufficient cash to pay its interest expense, its principal property was performing worse than anticipated, and its debt facility had recently been renegotiated to include additional covenants and a decrease in the borrowing limit. However, the RI continued to present boilerplate liquidity and capital resource disclosure in its MD&A, which consisted almost entirely of note disclosure from the audited financial statements.

While the RI in this example had disclosed that it had entered into a new debt facility and had decided to focus its efforts (and spending) on the further development of its principal property, there was no meaningful discussion of how these events impacted its liquidity and capital resource program. For example, no discussion was provided on how the new debt limit and covenants affected the RI's ability to raise the funds necessary for its development program, given the poor condition of its liquidity. There was also no discussion of the amount and nature of the expenditures committed, or not yet committed but required, to proceed with the focused development plan. In this case, we would have expected a comprehensive analysis of the various sources and uses of funding, and how those would be sufficient to continue operations and finance the capital expenditure program.

Some RIs have experienced increased covenant restrictions and decreased borrowing capacity that materially affect the composition of their capital resources. As a result, we would expect these RIs to include a discussion of the actual and expected changes in the mix and relative cost of their capital resources (i.e., the source of funds required to meet any shortfall resulting from a decreased proportion of debt), as required by paragraph 1.7(b) of Form 51-102F1. Alternatively, if there are no further sources of capital resources available, we have noted several RIs disclose decreases to their commitments for capital expenditures.

While we have generally seen timely disclosure of reductions in capital expenditures, the related analysis of the RIs' capital resources is not necessarily presented in a timely and thorough manner. We expect RIs to include discussion of which commitments for capital expenditures are impacted by these decreases and the anticipated impact of these decreases – specifically whether the expenditures are necessary to maintain current operations, or planned growth/development.

EXAMPLE THAT MET OUR EXPECTATIONS

An RI's September 30, 2015 interim MD&A, excerpts of the liquidity and capital resource disclosures:

The Company has $79 million drawn on its $95 million credit facility, which is subject to a semi-annual borrowing base redetermination that is ongoing. Based on current commodity prices, it is expected that the facility could be reduced. The Company is in active discussions with the banking syndicate regarding its borrowing base, an extension of the credit facility and other terms. The Company continues to advance and explore all alternatives to provide the necessary liquidity and capital to the Company based on the current commodity pricing environment. The redetermination is expected to be completed by November 30, 2015.

Capital expenditures for the year are substantially completed, with the Company having participated in the drilling of nine Property A wells. The capital expenditure budget for 2016 will be finalized upon completion of the credit facility discussions. Assuming the continuation or replacement of the facility, the capital budget is expected to be approximately $11 million for 2016, again focused on the Property A formation prospects. The Company has approximately 12,700 net acres with 15 more drilling locations currently identified.

For 2016, depending on the ability to finance the $11 million capital budget noted above, the Company has an annual production rate target of approximately 3,200 boe/d. This target represents limited capital to be incurred due to the current commodity price outlook.

Given the production outlook is a reduction from 2015, this disclosure could still be improved by providing the anticipated effect of the reduction in production on the RIs financial condition, financial performance and cash flows.

REMINDER

The instructions to the capital resources section of Form 51-102F1 state that an RI should discuss any exploration and development expenditures required to maintain properties or agreements in good standing; to the extent that these expenditures are affected by a decrease in capital resources, this should be clearly disclosed.

B. Covenants

We have focused on disclosures relating to debt covenants for several years, and in our reviews we have seen much improved disclosures; however, there are still RIs that have not provided the appropriate disclosure in their MD&A. Considering we have noted an increase in the prevalence of covenant breaches, renegotiations and RIs that are nearing a breach, this was especially relevant in our reviews this year.

As noted in previous years' Reports, the MD&A is meant to complement and supplement an RI's financial statements, discuss factors and risks that have affected, or are reasonably likely to affect, the RI's liquidity, capital resources and solvency. Sections 1.6 and 1.14 of Form 51-102F1 require an RI to describe and analyze risks associated with financial instruments, including when there is a significant risk of default or arrears on debt payments or covenant(s). Waiting to disclose this risk until after a covenant breach is unacceptable. In addition, the RI is required to disclose how it intends to address that risk.

Our expectation is that RIs discuss provisions in debt, lease or other arrangements that could trigger a material additional funding requirement or early repayment[6]; this would include both financial and non-financial covenants.

REMINDER

Given the direct impact oil prices are having on many of our RIs, several RIs have disclosed renegotiations of terms and decreases in credit facilities and borrowing limits; we anticipate more RIs will face these changes in the future. It is therefore important to present material changes in a timely manner.

[6] Instruction (ii(A)) to Section 1.6 – *Liquidity* in Form 51-102F1.

Financial Covenants

For RIs nearing a covenant benchmark (i.e., close to a breach) it is especially important that the description of the covenant is clear. In some cases, it may be necessary to present the actual calculation of the covenant in order to provide an appropriate level of understanding.

In one example, one of the RI's financial covenants was determined through a complex calculation. The disclosure of a qualitative description of the covenant and its components provided little value to investors since a reader would require the definitions that were in a separate agreement to be replicated and/or defined.

In such cases, we consider it necessary for the RI to disclose the actual calculation of the financial measure (in this case, a ratio) and the benchmark determined in the covenant, such that readers would be able to understand the RI's proximity to, and make their own assessment as to, the risk involved.

PRACTICE TIP

- We recommend disclosure of the actual covenant measure when an RI's covenant includes a trailing measure (e.g., trailing 12-month interest coverage) or components that are not disclosed in the financial statements.
- If a covenant includes reference to a non-GAAP measure, RIs should ensure that the MD&A includes the disclosures required by CSA Staff Notice 52-306 – *Non-GAAP Financial Measures and Additional GAAP Measures* **(SN 52-306)**, including a reconciliation to the closest IFRS measure.

Non-financial Covenants

In addition to the disclosure of financial covenants, RIs should disclose the non-financial covenants that are material to their credit agreements. In some circumstances, debtors have outlined milestones relating to production or sales that must be met; this type of covenant is sometimes inappropriately excluded from the RI's related disclosure.

We have also noted that some amendments to existing agreements have resulted in some uncommon covenants, such as requirements to make specific dispositions (e.g., selling a material property) in order to decrease the amount of debt carried, or significant changes to the repayment schedule.

In one example, the RI had disclosed during its second quarter 2015 that the bank had extended the facility review and borrowing base determination to June 30, 2015. On June 30, 2015 the RI had disclosed that for one of its facilities, a significant portion of the debt would need to be repaid in the first quarter 2016. The RI had filed the amended facility agreement with redactions to a certain covenant. The redacted covenant was the requirement that certain assets be recapitalized and divested and that a specified amount of the proceeds be used to repay the facility by a set date in the fourth quarter 2015. Given the material nature of this covenant, staff required the RI issue a news release to disclose the material terms of the covenant.

Disclosure of a Breach

While most RIs are diligent in disclosing the fact that a covenant breach has occurred, the timing of the disclosure and details included do not always meet our expectations.

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

The RI disclosed the following in its June 30, 2015 interim disclosures, filed August 11, 2015:

"As at June 30, 2015, the Company was not in compliance with certain financial covenants in its Credit Facility; however, waivers of such non-compliance were subsequently received effective for the second quarter of 2015."

Timing:
This was the first time that the RI disclosed the breach, despite knowing that a breach was imminent prior to June 30. Based on our correspondence with the RI, it had entered into discussions to obtain a waiver in mid-June. However, the RI's results of operations continued to deteriorate through the end of June and throughout July, resulting in continued discussions with its lending syndicate. As a result, the waiver was not finalized until August 9th.

Since the RI knew that it was in breach of certain covenants, our expectation is that it provide timely disclosure (e.g., by news release) rather than waiting for its next CD filing.

Nature of disclosures:
The RI's covenant disclosures were lacking, such that the specific covenants were not disclosed. In addition, the disclosure of the breach did not specify which covenants had been breached. As a result, investors would not be able to clearly understand the RI's liquidity condition (i.e., the magnitude of the breach). The RI agreed to improve its disclosure in its next CD filing to include disclosure of the covenants as well as the RI's actual results.

C. Variation

Discussion and analysis of significant variances continues to be an area where we note room for improvement in RI disclosures. While we have seen some progress with regard to the revenue side, costs of sales and other expenses are sometimes overlooked or discussed very generally.

In the past year, we have seen MD&A disclosure where RIs note decreases in operating costs due to declines in activity in the period; however, when we have requested further detail, we have noted that the decreases are not simply related to production. Several RIs have implemented austerity measures that include decreasing their labour costs (e.g., layoffs and salary cuts) and other discretionary expenses. This is very relevant information to disclose, but several RIs are not including this level of detail in their analysis.

In previous years' Reports, we have emphasized the importance of providing adequate depth of analysis, which includes an explanation of the underlying causes of the variances identified. This often includes a discussion of the changes in the factors that drive the results of operations. RIs should also consider the relationships between financial statement accounts such as the relationship between costs and revenues[7].

D. Quarterly Highlights

During the year, there were amendments made to the interim MD&A disclosure requirements as they apply to Venture RIs. These amendments apply for financial years beginning on or after July 1, 2015. Venture RIs will have the option to provide quarterly highlights disclosure in accordance with section 2.2.1 – *Quarterly Highlights* of Form 51-102F1, rather than the interim MD&A (section 2.2 – *Interim MD&A* of Form 51-102F1).

The quarterly highlights are meant to provide a short discussion of all material information about the Venture RI's operations, liquidity and capital resources. The disclosure should include an analysis of the Venture RI's financial condition, financial performance and cash flows and any significant factors that have caused period-to-period variations in those measures. The focus is on significant variances, trends, risks, major operating milestones, significant related party transactions and any commitments expected or unexpected events or uncertainties that have or are reasonably likely to have a material affect on the Venture RI's operations, liquidity or capital resources.

[7] Paragraph 1.4(f) of Form 51-102F1.

REMINDERS

- the quarterly highlights disclosure must provide a balanced and accurate discussion of the Venture RI;
- the disclosure must be titled "Interim MD&A-Quarterly Highlights";
- any requirements in NI 52-109 *Certification of Disclosure in Issuer's Annual and Interim Filings* that apply to interim MD&A will apply to the quarterly highlights; and
- if the first MD&A that a Venture RI files is an interim MD&A (i.e., a new RI), the Venture RI cannot use section 2.2.1 of Form 51-102F1; rather, it must provide an interim MD&A pursuant to section 2.2 of Form 51-102F1.

3.3 Other Areas

A. Venture Amendments

In addition to the amendments to the MD&A disclosure requirements, there were significant amendments made to several securities regulations that impact Venture RIs. These changes are intended to streamline disclosures and enhance certain governance requirements.

Executive Compensation

One change for Venture RIs was the introduction of the new form, Form 51-102F6V *Statement of Executive Compensation – Venture Issuers* to satisfy executive compensation disclosure requirements.

Some of the significant changes include: decreasing the number of named executive officers that an RI must include in its disclosure from five to three; decreasing the number of years to report from three to two; and omitting or simplifying the tables that are required by Form 51-102F6 *Statement of Executive Compensation*.

In addition to the new form, the Venture RI amendments also clarified the filing deadlines for executive compensation disclosure for years beginning on or after July 1, 2015. Specifically, if an RI is required to send an information circular, it must provide the required executive compensation disclosure no later than 180 days after the Venture RI's most recently completed financial year (140 days for a non-venture RI), per subsection 9.3.1(2.2) of NI 51-102.

For an RI that is not required to send, and does not send, an information circular, and that does not file an AIF that includes executive compensation disclosure, the disclosure required by subsection 11.6(1) of NI 51-102 is required to be filed within 140 days of the RI's year end.

Significant Acquisition Threshold

A significance threshold for acquisitions is used by Venture RIs when determining:

- whether a Business Acquisition Report **(BAR)** must be filed in accordance with Part 8 of NI 51-102;
- what disclosure is required with respect to an acquisition under Item 14 of Form 51-102F5 *Information Circular*; and
- what disclosure is required with respect to an acquisition under Item 35 of Form 41-101F1.

The significance threshold increased from 40 per cent to 100 per cent in order to decrease the number of instances that Venture RIs would be required to file a BAR. Harmonization with the information circular and long-form prospectus requirements was maintained for consistency.

> *REMINDER*
>
> Despite the increased significance threshold, when filing an IPO, issuers need to consider whether an acquisition would meet the definition of primary business in Item 32 of Form 41-101F1.

National Instrument 52-110 Audit Committees (NI 52-110)

Part 6 – *Venture Issuers* of NI 52-110 currently provides an exemption for Venture RIs from the requirements of Part 3 – *Composition of the Audit Committee* and Part 5 – *Reporting Obligations*; however, for financial years beginning on or after January 1, 2016, Venture RIs will be subject to the amendments to Part 6.

Specifically, audit committees of Venture RIs will be required to be composed of a minimum of three members, every member must be a director of the Venture RI, and a majority of the members must not be executive officers, employees or control persons of the Venture RI or of an affiliate of the Venture RI (subject to the exceptions in subsections (4), (5) and (6) of section 6.1.1 of NI 52-110).

Form 41-101F1

Finally, the amendments decreased the reporting requirements in several sections of Form 41-101F1 such that Venture RIs are only required to provide two years (rather than three) of historical disclosure regarding:

- bankruptcy of the Venture RI or any of its subsidiaries, and the nature and results of any material restructuring (subsections 5.1(2) and 5.1(3) of Form 41-101F1);
- how the Venture RI's business has developed (section 5.2 of Form 41-101F1); and
- financial statements (exemption now extended to IPO Venture Issuers (as that term is defined in National Instrument 41-101 *General Prospectus Requirements*)) (subsection 32.4(1) of Form 41-101F1).

> *REMINDER*
>
> Venture RIs and IPO Venture Issuers should keep in mind how the quarterly highlights (MD&A), significant acquisitions threshold, executive compensation and audit committee amendments affect their prospectus disclosure requirements.

B. IOR – Shelf Prospectus Supplements

During the year, we conducted an IOR of disclosures provided in, and related to, base shelf prospectuses and shelf prospectus supplements **(Supplements)** to assess compliance with National Instrument 44-102 *Shelf Distributions*. We reviewed these filings for 24 RIs that had filed a base shelf prospectus and/or Supplement(s) during the year. Based on our reviews, we did not find any significant deficiencies; however, for 25 per cent of the RIs, we sent comment letters requesting prospective changes.

By far, the most common issue was unclear or inconsistent use of proceeds disclosure. Several RIs disclosed in their Supplements that the proceeds from that distribution would be used for one purpose (e.g., paying down indebtedness), while subsequent disclosure documents (financial statements, MD&As, etc.) identified other material uses of those funds.

Since the Supplement is meant to contain all of the shelf information that was not disclosed in the corresponding base shelf prospectus, this is where most RIs include the detailed use of proceeds disclosure. The requirement is to disclose in reasonable detail each of the principal purposes, with approximate amounts, for which the net proceeds will be used by the RI[8]. Further, if the RI uses a material portion (over 10 per cent of the net proceeds) of the proceeds to reduce indebtedness or to complete an asset acquisition, there are additional disclosures required pursuant to sections 4.3 and 4.4 of Form 44-101F1.

[8] Section 4.2 *Principal Purposes – Generally* of Form 44-101F1 *Short Form Prospectus* **(Form 44-101F1)**.

To the extent that the inconsistencies noted are due to unexpected changes in the use of proceeds subsequent to the distribution under a Supplement, we expect the MD&A filing for the relevant period to present a comparison in tabular form of the use of proceeds disclosure the RI previously made in the Supplement to the actual uses, along with a discussion of the variances, as required by paragraph 1.4(i) of Form 51-102F1. We did not find this to be the case; as a result, these RIs were reminded to include this information in their future disclosures.

REMINDER

Some RIs continue to disclose that the net proceeds of the distribution will be used for “general corporate purposes.” We remind RIs that this phrase is not generally sufficient to meet the prospectus disclosure requirements.

C. Reclamation Costs

In December 2014, the CSA issued amendments to NI 51-101 that were effective July 1, 2015. To further remind RIs and their IQREAs[9] of certain aspects of the amendments, the CSA recently issued CSA Staff Notice 51-345 *Disclosure of Abandonment and Reclamation Costs in National Instrument 51-101 Standards of Disclosure for Oil and Gas Activities and Related Forms*.

The amendments included a definition of future net revenue, clarifying that future net revenue must be presented net of abandonment and reclamation costs (as that term is defined in the amended instrument). Despite this clarified definition, RIs are reminded that estimates of future net revenues disclosed do not represent fair market value.

As a result, there are additional considerations that RIs must make in order to determine the fair market value for accounting purposes, particularly when preparing their impairment analysis. Many of the estimates used in an RI’s NI 51-101 disclosure (e.g., future revenues, royalties, operating expenses, development costs and abandonment and reclamation costs) should be considered in a discounted cash flow model; however, the RI must determine the appropriate adjustments it needs to make.

There is some diversity in practice as to how decommissioning provisions are treated in an impairment analysis. One approach is to exclude cash flows relating to the settlement of decommissioning provisions, and also exclude the decommissioning provision recognized within the financial statement from the carrying amount of an asset or CGU. A second approach is to include cash outflows in the discounted cash flow model, and reduce the carrying amount by the decommissioning provision. Both approaches may utilize abandonment and reclamation costs from the reserve report in a discounted cash flow model.

Staff is concerned that using inputs from the reserve report and/or the accounting records without proper adjustment may lead to the recoverable amount not being determined on a basis consistent with the CGU and an overstatement of cash flows that shelter impairment losses.

D. Forward-Looking Information

We have discussed the requirements and noted weaknesses related to FLI disclosure in several past Reports; however, this remains an area where RIs should improve their disclosures. While there has been improvement for some of the issues we have identified, we continue to note many deficiencies that result in comment letters.

Withdrawal

During the year, we noted a few RIs removed previously disclosed FLI. The additional disclosure, required by section 5.8 – *Disclosure Relating to Previously Disclosed Material Forward-Looking Information* of NI 51-102, was not always presented. Specifically, if an RI decides to withdraw previously disclosed material FLI, the RI must disclose in its MD&A the decision and discuss the events and circumstances that led the RI to that decision,

[9] Independent Qualified Reserves Evaluator or Auditor.

including the assumptions underlying the FLI that are no longer valid[10]. We noted a few examples where FLI was withdrawn during a period when the results were not as positive as the previously disclosed outlook. In these situations, it is especially important to ensure that readers are aware of the withdrawal in order to provide a balanced and complete discussion of the RIs operations and condition.

In one example, the RI had presented in its annual 2014 MD&A Outlook section that it was targeting a debt to cash flow of less than 1.75 to 1 for each period in 2015. We noted that the September 30, 2015 interim report no longer disclosed this metric – neither in the current results, nor the outlook section for the upcoming periods – as it had in the first two quarters of 2015. When we recalculated the measure, we noted that this was the first period where the RI had not met its target. Since there was no explanation for this omission, we issued a comment requesting that the required disclosure be included in the RI's next MD&A.

Acquisitions and Dispositions

In last year's Report we highlighted some disclosure deficiencies, and our resulting expectations, when RIs discuss the impact of material acquisitions and dispositions. During the year, we have seen an increase in the prevalence of material dispositions; however, in general, the level of disclosure is much lower than what RIs have disclosed for comparable acquisitions.

We remind RIs that several sections of the MD&A Form require forward-looking discussion of the expected fluctuations in liquidity and capital resources (e.g., decreases to credit facility limits) and the anticipated effect on the RI's financial condition, financial performance (e.g., revenues, production) and cash flows[11] resulting from a proposed disposition.

EXAMPLE THAT MET OUR EXPECTATIONS

An RI disclosed in a news release the following regarding a disposition:

The Company today announced that it has entered into an agreement for the sale of its non-core XYZ assets in northern Alberta for cash consideration of $150 million. With the sale of XYZ as well as previously closed dispositions, total expected disposition proceeds are now in excess of $450 million in 2015. The Company remains confident that it will successfully achieve its $700 million disposition target in 2015. The expected proceeds from these non-core asset sales will be directed towards reducing the Company's outstanding debt as part of the Company's strategy of strengthening its balance sheet.

The Company's average daily production from XYZ was approximately 6,400 barrels of oil equivalent per day (boe/d) (weighted approximately 75 percent towards liquids), with annualized third quarter cash flow of $24 million and annualized net operating income of $32 million. Proved plus probable (2P) reserves attributed to the liquidated assets were 19.2 million boe as at December 31, 2014, according to the independent reserve evaluators.

The XYZ assets are non-core assets, which are not strategic to the Company's long-term business objectives and are not likely to receive any future capital under the Company's current business plans. The sale is expected to enhance the Company's operational efficiency as the disposition will reduce the Company's well bore count by approximately 3,900 gross wells. This sale is expected to result in administrative savings as well as favourably impact the Company's asset retirement obligation.

Subject to customary regulatory and other closing conditions, the XYZ disposition is expected to close on or before October 31, 2015. The sale of the XYZ assets is not expected to materially affect full-year 2015 average production guidance and the Company expects 2015 production to remain between 95,000 and 98,000 boe/d.

A reader may be able to determine some of the anticipated effects on the RI's financial performance by assuming a reduction of the historical production, cash flows and net operating income attributed to the disposed assets; however, some of the disclosures remain quite general. This disclosure could still be improved by quantifying the effect of the disposition on the operational efficiency, administrative savings and asset retirement obligations.

Note: In addition to the excerpt above, the RI presented appropriate FLI disclosure required by Part 4A of NI 51-102 (e.g., identification of the FLI, material factors and assumptions used).

[10] Subsection 5.8(5) of NI 51-102.

[11] Sections 1.6 *Liquidity*, 1.7 *Capital Resources* and 1.11 *Proposed Transactions* of Form 51-102F1.

In addition, while there has been some improvement in disclosures regarding proposed acquisitions, we still see some RIs that use vague language to describe the expected effect of these transactions.

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

An RI disclosed in its annual 2014 MD&A the following regarding an acquisition:

"The acquisition of ABC is expected to be accretive to the Company on an EBITDA, cash flow, and earnings per share basis."

"The arrangement will result in a financially stronger Company."

This was the extent of the discussion regarding the impact that this material acquisition was expected to have on the RI. There were no supporting quantitative details and the RI lacked all of the FLI disclosure required by Part 4A of NI 51-102.

This resulted in a request for changes in the RI's next MD&A to include the missing disclosures.

E. Promotional Disclosure

During the past year, we were pleased to note a general decrease in some of the promotional disclosure that we had seen in the past; however, one area where we identified unbalanced disclosure was with respect to announcements relating to dividends and distributions.

While RIs are prompt in their disclosure of increases to their dividends, often issuing news releases for the sole purpose of presenting the dollar amount and percentage increase, we do not always see the same level of disclosure for decreases.

Some RIs have had multiple decreases to their distributions throughout the year but have not identified them as such. For example, we have seen news releases that announced a quarterly dividend and disclosed the dollar amount, but they did not disclose the historical dividend amounts or mention the fact that this represented a significant (e.g. 50 per cent) decrease from the previous dividends. In other cases, we note the discussions relating to significant dividend decreases and even full suspensions buried near the end of a lengthy news release on an unrelated topic. The relative lack of prominence of this information, which in some cases could signify a material change for the RI, is not appropriate and can result in disclosure that the ASC considers to be misleading.

F. Non-GAAP

The presentation of non-GAAP financial measures continues to be an area of focus since we are noting greater prevalence of non-GAAP financial measures in RI disclosures and we repeatedly find issues with them.

During the past year, we noted several RIs did not provide specific disclosure explaining the usefulness of the non-GAAP financial measure. We also noted a disconnect between the RI's explanation of a non-GAAP measure's relevance and the reconciliation between the measure and the most directly comparable GAAP measure.

The disclosure accompanying non-GAAP financial measures that is set out in SN 52-306 is required specifically to ensure that the non-GAAP measure is not misleading to investors; without an appropriate and accurate explanation of why the non-GAAP measure provides useful information and the additional purposes for which management uses the non-GAAP measure, an RI may be presenting misleading disclosure.

EXAMPLE THAT DID NOT MEET OUR EXPECTATIONS

An RI disclosed the following in its annual MD&A:

"Cash Available for Distribution: is defined as EBITDA less cash income taxes and financial expense. Management believes that Cash Available for Distribution as a <u>liquidity measure</u> is a useful supplemental measure as it provides an indication of the amount of cash available to pay as dividends to shareholders."

Since this non-GAAP measure was reconciled to net income (through EBITDA) rather than cash flow from operations, it appeared to be a performance metric rather than a liquidity measure.

The RI acknowledged that the disclosure was inappropriate since the RI's ability to sustain its dividends over an extended period is directly tied to its ability to generate earnings from its operations and not tied to temporary working capital fluctuations that are represented in the cash flow from operating activities. As a result, the RI indicated it would amend its future disclosure to reference the non-GAAP as a performance measure rather than a liquidity measure.

PRACTICE TIP

With the increased prevalence of non-GAAP measures, we have seen some RIs disclosing multiple non-GAAP measures related to a single most directly comparable IFRS measure. Presenting the IFRS measure first is not always sufficient to give it equal or more prominence than the non-GAAP measures (as required by SN 52-306). The disclosure should be taken as a whole to determine if the presentation of all the non-GAAP measures could confuse or mislead readers.

4. Contact Personnel and Other Information

Feedback on the Report and Other Corporate Finance Matters

We welcome comments on this Report and other Corporate Finance matters. Comments may be directed to any of the individuals listed below:

Cheryl McGillivray, CA
Manager, Corporate Finance
(403) 297-3307
cheryl.mcgillivray@asc.ca

Anne Marie Landry, CA
Senior Securities Analyst
(403) 297-7907
annemarie.landry@asc.ca

Upcoming Presentations

From time to time, the ASC hosts webinars and in-person seminars on various topics related to securities requirements including CD matters. Breakfast seminars related to this Report and other topics are scheduled for Calgary on January 19 and Edmonton on January 20, 2016; please check our website for details and registration. A related webinar is scheduled for January 19, 2016. If anyone planning on attending one of the above seminars or webinars has a specific topic or question that they would like us to address at an upcoming session, we would be pleased to consider your request. Please submit your topic or question to cf-report@asc.ca by January 11, 2016. We will consider submissions after this date for potential future presentations. Information about future seminars and webinars can be found on the ASC website at www.albertasecurities.com. Archived presentation slides and related reference materials from past seminars are also available on the ASC website[12].

[12] Available under “Events & Presentations” in “News & Publications”.

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